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No. 93-486

In The

Supreme Court of the United States

October Term, 1993

FRANK KELLY, MARIA KELLY, JUAN ANTONIO BRANDO, BERTA LASERNA, RAFAEL DAVID POLEO ISAVA, ELLIO CIOCCA, DANIEL PRADO FLORES, MAX GOMEZ, WILLIAM MACKAY, ANTONIA MACKAY, GONZALO BARQUERO, ABRAHAM STEFAN, OSVALDO CORDOVA, RUDY ZEPEDA, THOMAS BOVEE, RICARDO SUCRE, and AGROPECUARIA MILLON, C.A., a foreign corporation,

Petitioners,

vs.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., a Delaware corporation,

Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

REPLY TO BRIEF IN OPPOSITION

THOMAS H. SEYMOUR,
Counsel of Record
HARRY R. SCHAFER
SCOTT E. PERWIN
KENNY NACHWALTER SEYMOUR
ARNOLD CRITCHLOW & SPECTOR, P.A.
400 Miami Center
201 S. Biscayne Boulevard
Miami, Florida 33131
Telephone: (305) 373-1000
Attorneys for Petitioners

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (302) 342-2831

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REPLY TO BRIEF IN OPPOSITION

Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") has released a torrent of irrelevancies in a valiant but unsuccessful effort to obscure the

relatively straightforward legal issues as to which Petitioners* seek this Court's review: (1) whether issues of *res judicata* are an exception to the federal policy requiring enforcement of valid pre-dispute arbitration agreements; and (2) whether a party who executes an agreement requiring or permitting bifurcated judicial and arbitral proceedings may nevertheless urge in defense that the plaintiff has split his claim. Petitioners respectfully suggest that these issues are worthy of this Court's consideration, and that the petition for certiorari should be granted.

We reply briefly to Merrill Lynch's principal arguments below.

A. *The court of appeals ignored the important federal policy reflected in the Federal Arbitration Act.* Merrill Lynch argues that "[t]he Federal Arbitration Act does not address the question of how a claim of *res judicata* based on a district court judgment should be resolved. . . ." Brief at 10. In fact, this Court more than 25 years ago interpreted the Federal Arbitration Act to provide that, when presented with a dispute covered by an enforceable arbitration agreement, a district court "may consider *only* issues relating to the making and performance of the agreement to arbitrate." *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967) (emphasis added). *Res judicata* relates to neither. *Res judicata* is instead an affirmative defense to the underlying claim, *see* Fed. R. Civ. P. 8(c), and, like other such defenses, should be

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* The single corporate Petitioner has no parent companies or subsidiaries.

referred to arbitration and resolved by the arbitrators in the course of resolving the underlying claim.[1] The proposition that defenses to arbitrable claims are themselves arbitrable is simply an application of the general rule that "[p]arties who agree to submit matters to arbitration are presumed to agree that everything, both as to law and fact, necessary to render an ultimate decision is included in the authority of the arbitrators." *Ormsbee Dev. Co. v. Grace*, 668 F.2d 1140, 1146 (10th Cir.), *cert. denied*, 459 U.S. 838 (1982).

Merrill Lynch suggests that these normal procedures are somehow altered by the fact that a court was involved in rendering the judgment on which the defense of *res judicata* is based, but fails to articulate or explain the basis for that suggestion. It is hardly normal or commonplace for a rendering court to pass on the preclusive effect of its own judgment. *See Donovan v. City of Dallas*, 377 U.S. 408, 412 (1964) (litigants had a right to pursue their claims in

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[1] *See e.g., Lawrence v. Comprehensive Business Services Co.*, 833 F.2d 1159 (5th Cir. 1987) (illegality); *Saturday Evening Post Co. v. Rumbleseat Press, Inc.*, 816 F.2d 1191, 1198-99 (7th Cir. 1987) (invalidity of copyright as defense to claim for breach of license agreement); *Mar-Len of Louisiana, Inc. v. Parsons-Gilbane*, 773 F.2d 633, 636 (5th Cir. 1985) (economic duress); *Rhone-Poulenc Specialities Chimiques v. SCM Corp.*, 769 F.2d 1569, 1572 (Fed. Cir. 1985) (scope, validity and infringement of patent as defense to claim for breach of license agreement); *County of Durham v. Richards & Assoc., Inc.*, 742 F.2d 811, 815 (4th Cir. 1984) (statute of limitations); *Sauer-Getriebe KG v. White Hydraulics, Inc.*, 715 F.2d 348, 350 (7th Cir. 1983) (lack of consideration, unconscionability and vagueness), *cert. denied*, 464 U.S. 1070 (1984); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Haydu*, 637 F.2d 391, 398 (5th Cir. Feb. 19, 1981) (duress and unconscionability).

federal court, despite defense of *res judicata*, and "whether or not a plea of *res judicata* in the second suit would be good is a question for the [second] court to decide"); 18 C. Wright et al., *Federal Practice and Procedure* § 4404 at 32 (1981) ("Ordinarily both issue preclusion and claim preclusion are enforced by awaiting a second action in which they are pleaded and proved by the party asserting them"). These and hundreds of other authorities stand for the proposition that *res judicata* is in the first instance a defense rather than a basis for injunctive relief. Given the important federal policies embodied in the Federal Arbitration Act, there is even more reason than usual for Merrill Lynch's *res judicata* defense to be considered and resolved by means of arbitration, as the parties agreed, rather than by the rendering court.

Similarly, Merrill Lynch simply begs the question when it insists that "[t]he federal policy favoring arbitration is not implicated until the district court has had an opportunity to decide . . . whether or not all claims have already been resolved by prior litigation." Brief at 14. Petitioners' rights under the Merrill Lynch arbitration agreement and the Federal Arbitration Act *include* the right to an arbitral determination of "whether or not all claims have already been resolved by prior litigation." One could just as well argue that the federal policy favoring arbitration is not "implicated" until a district court decides whether the claims in arbitration can survive a statute of limitations defense. Yet it is settled that such a defense is subject to arbitration. *See e.g., County of Durham v. Richards & Assoc., Inc.*, 742 F.2d 811, 815 (4th Cir. 1984).

B. *The court of appeals created a perverse and untenable rule of res judicata.* Merrill Lynch is mistaken in contending that Petitioners refrained from pursuing their common-law claims in the federal securities litigation in order to preserve their credibility before the district court. Brief at 6.[2] Petitioners refrained from pursuing their common-law claims in the federal litigation because they had agreed not to litigate those claims. *See Blue Gray Corporations I and II v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 921 F.2d 267, 271 (11th Cir. 1991) (arbitration agreement containing identical language "clearly provided for state law claims to be arbitrated, even those which arise out of the same transactions or occurrences as federal securities law claims").[3]

More fundamentally, much of Merrill Lynch's argument appears to rest on the premise that only *defendants* are permitted to invoke a contractual right to arbitrate. *E.g.*, Brief at 7 (characterizing Petitioners' argument as an argument that Petitioners' common-law claims could not

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[2] Merrill Lynch makes much of the supposed "inconsistency" between the claims raised before the district court and those raised before the NASD arbitration panel, but never attempts to explain how that supposed inconsistency bears on the issues before this Court. If Merrill Lynch believes that Petitioners' arbitrable claims violate the doctrine of judicial estoppel or some other unidentified limitation on taking inconsistent position in successive proceedings, it is free to raise that argument before the arbitration panel.

[3] *J.D. Marshall Int'l, Inc. v. Redstart, Inc.*, 656 F. Supp. 830 (N.D. Ill. 1987), to which Merrill Lynch devotes half a page of its brief, did not involve an agreement to bifurcate proceedings of the sort involved here. Our argument against the application of *res judicata* is based on the existence of such an agreement.

have been raised in the federal action "because Merrill Lynch could have sought to compel arbitration of those claims"); *id.* at 19 ("There was no requirement that Merrill Lynch move to compel arbitration of those claims"). Even in the sole instance where Merrill Lynch appears to acknowledge that the right to arbitrate is symmetrical, it is uncommonly grudging in its description of that right. *See id.* at 9 (the Merrill Lynch arbitration agreement "simply enabled either party to compel arbitration of state law claims"). Apparently, Merrill Lynch is advancing the notion that the arbitration agreement gave Petitioners the right to *compel* arbitration (of what?) but not the right to initiate arbitration in the first instance. The basis for that view is not explained.[4]

In fact, by providing that claims other than federal securities claims "*shall*" be arbitrated, the Merrill Lynch arbitration agreement not only *permitted* but *required* Petitioners to arbitrate their common-law claims, and Petitioners properly honored that agreement. They should hardly be penalized for doing so. What Merrill Lynch denigrates as a "disingenuous spectre" (Brief at 19) is in fact an unavoidable consequence of the rule adopted by the court of appeals. If the lower courts' ruling is permitted to stand, securities plaintiffs will have no practical

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[4] Likewise, Merrill Lynch's observation that the language of the agreement "merely recognized" that arbitration of federal securities claims "could not be contractually compelled" (Brief at 17) is inconsistent with the law of most circuits and, indeed, with the law of this case. *See Blue Gray Corporations I and II v. Merrill Lynch*, 921 F.2d at 271 ("The arbitration clause in this case did more than merely notify the plaintiff of the existing state of the law; it expressed the agreement between the parties").

choice but to breach valid arbitration agreements and submit to already overburdened federal courts claims which would otherwise be resolved in extrajudicial arbitration. That result will not be limited, as Merrill Lynch contends, to situations in which the plaintiff's federal claims and arbitrable claims are (in Merrill Lynch's estimation) "inconsistent."[5]

Under section 26(1)(a) of the Second Restatement of Judgments, the defense of *res judicata* is unavailable where "[t]he parties have agreed in terms or in effect that the plaintiff may split his claim." Although Merrill Lynch does not discuss section 26 in its opposing brief, it has previously acknowledged that section 26 is an accurate statement of federal common law. Moreover, as the Eleventh Circuit recognized below, the Merrill Lynch arbitration agreement is undeniably an agreement of the kind described in the Restatement. *See* 985 F.2d at 1070 ("The [Merrill Lynch arbitration] agreement . . . allowed plaintiffs to institute two suits based on the same events"). It follows that the lower courts erred in holding that Merrill Lynch has a valid *res judicata* defense. Because of the

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[5] Merrill Lynch's attempt to distinguish *Clark v. Bear Stearns & Co.*, 966 F.2d 1318 (9th Cir. 1992), is unpersuasive. As Merrill Lynch itself acknowledges (at page 16), a judgment is ordinarily entitled to preclusive effect even when both proceedings have been put into motion simultaneously. Thus, under the Eleventh Circuit's reasoning in this case, the plaintiff's federal securities claims in *Clark* should have been barred by the preclusive effect of the prior arbitration. In our view, the Ninth Circuit's rejection of that result was implicitly based on the recognition that the parties had agreed to the splitting of the plaintiff's claims.

potentially far-reaching consequences of that ruling, Petitioners respectfully suggest that this Court should grant certiorari in order to review the decision of the court of appeals.

CONCLUSION

Petitioners respectfully contend that the petition for certiorari should be granted.

Respectfully submitted,

THOMAS H. SEYMOUR,
Counsel of Record
HARRY R. SCHAFER
SCOTT E. PERWIN
KENNY NACHWALTER SEYMOUR
ARNOLD CRITCHLOW & SPECTOR, P.A.
400 Miami Center
201 S. Biscayne Boulevard
Miami, Florida 33131
Telephone: (305) 373-1000
Attorneys for Petitioners

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